In This Building Block:

- Understanding cash, bonds, and stocks
- How the investments stack up
- Reducing risk
- A quiz: What's your comfort level?

WHAT TO CONSIDER WHEN INVESTING

In Building Block #2 you learned about how much money you'll need for retirement and how much of your salary to contribute to the Deferred Compensation Plan. If you didn't read Block #2, look at the table on page 10 for an estimate of how much of your pay to save. Now that you have this figure, you'll need to know more about investing and what to consider as you save for retirement through the Deferred Compensation Plan.

Choosing investments is a very personal decision. It all comes down to what you expect and when you need your money. Whether you are saving for retirement 20 years down the road or just around the corner, you need to know what to expect from your investments. This Building Block provides the performance history and risks of each investment option. It also gives you tips on how you can reduce the risks of investing. Of course, knowing how investments performed in the past is no guarantee they will continue to perform the same in the future, but it's a good place to start.

What are cash, bonds, and stocks?

Cash, bonds, and stocks are three different types of securities. Think of them as the basic tools you can use to build your retirement account. Just as you would make sure you had the right tools for building a fence or hooking up a sink, you should have the right tools to help you reach your investment goal.

Cash offers investors stability

"Cash" includes money market securities, such as short-term investments in U.S. Treasury bills, bank certificates of deposit, banker's acceptances, and short-term IOUs issued by corporations. A cash investment represents a loan to a government or a corporation. The IOU promises to repay the original loan plus interest.

Money market investments are generally issued for a period (called a maturity) of one year or less. Because of their very short maturities, which makes them less risky, cash investments usually pay less interest and go up and down in price less than bonds. Historically, cash investments delivered the lowest returns of the three types of securities — cash, bonds, and stocks.

Bonds seek to provide income

When governments and corporations need to borrow money, they issue a bond. A bond is another type of IOU borrowers give investors who lend them money. The IOU explains the terms of the loan, including how much interest is to be paid, and when. Bonds are also called debt instruments.

Bonds are issued for a set period. At the end of that period — called the "maturity date" — the bond issuer is required to repay the original loan (the principal). Bonds are generally grouped according to their maturities: short-term — less than 5 years; intermediate-term — 5 to 10 years; and long-term — more than 10 years.

Bonds are very different from stocks. They usually offer a more consistent level of income and, over time, may be more stable in price than stocks. Of course, since bonds are typically less volatile than stocks, the potential return of bonds is also generally lower.

Stocks seek long-term growth

When you invest in stocks, you become part owner of a company. Because you own a piece of the company, stocks are sometimes called “equity” investments.

Here’s how stock investments work: A corporation issues stock to raise money to run its business. The stock is sold in units called shares. When you buy shares of stock, you hope their value will grow over time.

Owners of stock can profit if a company’s earnings increase, which may result in a higher share price. If shareholders sell shares worth more than they paid for them, they realize a capital gain. Shareholders may also profit if a company pays them dividends. Because dividends are based on a company’s profits, they vary from company to company and from year to year.

A company’s stock price usually rises or falls with the company’s earnings. Stock prices are also affected by factors beyond the company’s control, such as interest rates, politics, the health of the company’s particular industry, and the stock’s popularity with investors.

Because of their sharp ups and downs, stocks represent greater risk than bonds and cash. The greater a stock’s potential for gains, the greater the risk.

A mutual fund is a collection of investments

One of the easiest ways to invest is through funds. Think of a fund as a basket filled with a variety of securities, such as stocks, owned by many investors. The contents of each basket vary, depending on the goal of the fund. When you invest in a mutual fund, you share ownership of everything in the basket.

Investment performance

To make smart investment choices, you need to know how cash, bonds, and stocks have behaved. This is sometimes called an investment's performance history.

When most investors say performance, they mean total return. An investment's "total return" is its capital appreciation plus earnings over a specific period, such as a quarter or a year, expressed as a percentage.

What returns mean to you

The chart on the next page shows how an investment of $100 invested at the beginning of 1970 in stability-oriented, income-oriented, and growth-oriented investments would have fared over 30 years.

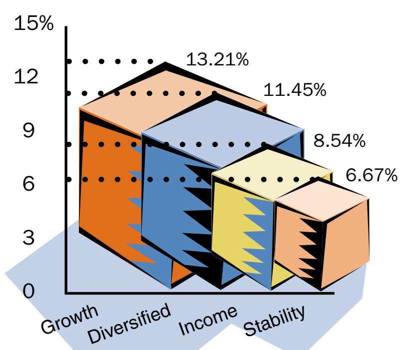
Look beyond return

While return is important, you should never evaluate an investment's performance on the basis of return alone. Factoring risk into your decision can help you avoid unpleasant surprises, and it will give you some idea of what could happen in the future.

Return is usually stated as a percentage of the investment's growth over a specific period. For example, a $100 investment that earned $8 over the year and grew to $108 had an 8% annual return.

Performance of different asset classes

Average annualized returns 1970-2000

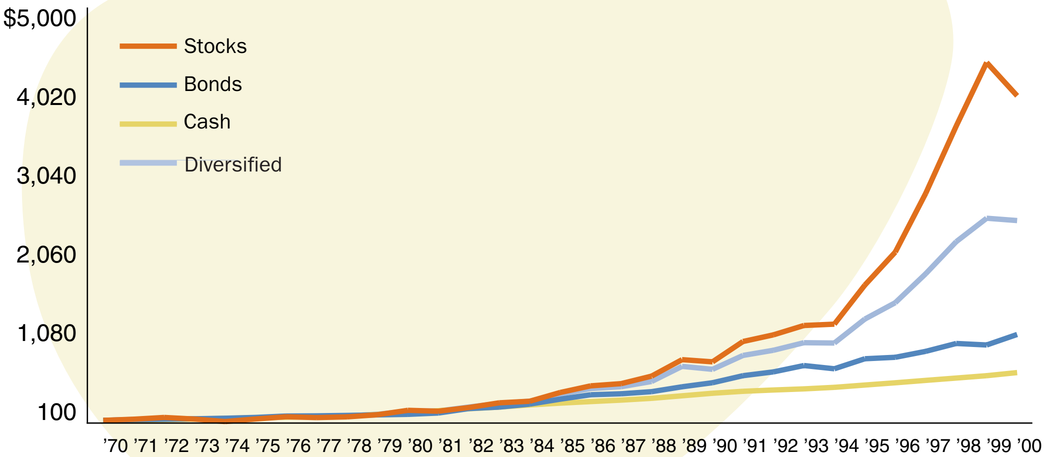


Returns of the stability portfolio are based on 30-day U.S. Treasury bills; returns of the income portfolio are based on U.S. intermediate-term government bonds; returns of the growth portfolio are based on the S&P 500; and the returns of the diversified portfolio are based on a portfolio of 10% 30-day U.S. Treasury bills, 30% U.S. intermediate-term government bonds, and 60% S&P 500. All index returns supplied by Ibbotson Associates. Unlike stocks, T-bills and T-bonds are guaranteed as to the timely repayment of interest and principal. Past performance does not guarantee future results.

Source: Ibbotson Associates. Analysis: T. Rowe Price Associates.

Growth of $100 over 30 years

1970-2000



Assumes $100 invested on 12/31/70 with returns compounded yearly. Figures include changes in principal value and reinvested dividends and assume the same asset mixes are maintained each year. Chart is for illustrative purposes only and is not intended to represent the performance of any of the investment options available in the plan. Past performance does not guarantee future results.

Source: Ibbotson Associates. Analysis: T. Rowe Price Associates. Growth = S&P 500 stocks (the S&P 500 Index measures the average performance of 500 widely held common stocks); income = U.S. intermediate government bonds; stability = 30-day Treasury bills; diversified = 10% 30-day U.S. Treasury bills, 30% U.S. intermediate-term government bonds, and 60% S&P 500. Unlike stocks, T-bills and T-bonds are guaranteed as to the timely repayment of interest and principal.

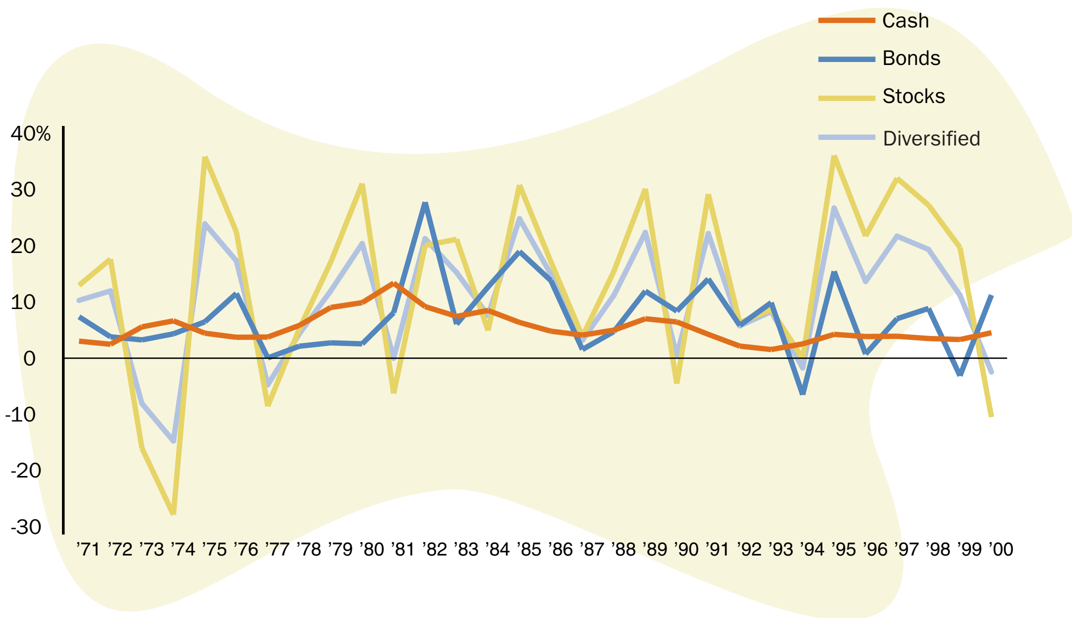
When investing, knowing *where* you want to go is the obvious place to start; knowing what the ride will be like is just as important.

Understanding risk

We all hope our investments will always go up in value. But sometimes they may drop. The extent to which an investment goes up and down is considered its volatility. When you read about an investment's risk level, it is usually referring to volatility risk.

More volatile investments, such as stocks, have shown losses some years, but have earned a higher return over time than other types of securities. More stable investments, such as cash, rarely lose money in a given year, but earn less over the years. The chart below shows the ups and downs in value for cash, bonds, and stocks for 29 years (1971-2000).

Ups and downs of cash, bonds, stocks, and diversified portfolios over 29 years



Inflation risk

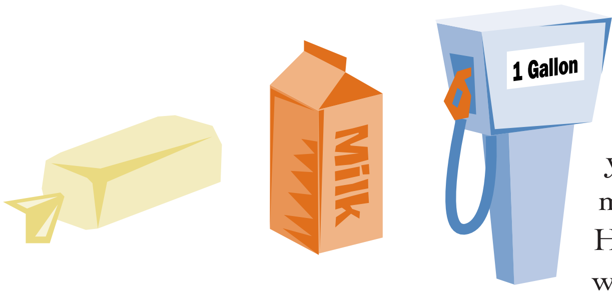
Inflation is another kind of risk — the possibility an investment won't grow enough over time to keep pace with inflation. For example, passbook savings accounts at a bank, which are insured and offer a fixed rate of return, carry no volatility risk but generally offer lower long-term returns, so they run the risk of not keeping up with inflation.

Many Plan participants believe the best way to build a nest egg for retirement is to protect their money by investing in the lowest-risk funds. This strategy may give you peace of mind today, but you may be sacrificing your future financial security as inflation erodes your investment's value.

Past performance does not guarantee future results. Figures include changes in principal value and reinvested dividends and assume the same asset mixes are maintained each year. Chart is for illustrative purposes only and is not intended to represent the performance of any specific fund.

Source: Ibbotson Associates. Analysis: T. Rowe Price Associates. All rights reserved. Stocks = S&P 500; bonds = U.S. intermediate government bonds; cash = 30-day Treasury bills. Unlike stocks, T-bills and T-bonds are guaranteed as to the timely repayment of interest and principal.

What things will cost



	Bread (loaf of white)	Milk (half gallon)	Gas (one gallon)
Year 2002	$1.00	$2.06	$1.68
Year 2020	$2.03	$4.17	$3.40

Source: T. Rowe Price Associates (assumes an inflation rate of 4% a year)

Inflation poses the biggest risk to most retirement investors. Think of inflation two ways: it's the price of things going up each year. Or, it's the loss of your money's value over time. Here's why inflation is a risk: when you retire, your income stays the same while your living expenses continue to grow.

Inflation nibbles away at the value of your investments every year. Growth-oriented investments like stock funds have the potential to beat inflation and provide potentially higher returns over the long term.

Other considerations: your age, expectations, and finances

Your age

The number of years you plan to leave your money invested is key to your investment strategy. Consider the following situations:

- If you are in your 20s, your career is still ahead of you. You may be comfortable with investments that carry more risk because you have time to ride out downturns.
- If you are close to retirement, you may want to be more cautious because you don't have the time to wait for a down market to bounce back.

Your expectations

Knowing your lifestyle and what to expect from your investments should give you a level of comfort. For example:

- Do you expect to upgrade your lifestyle in retirement, or will you be content to maintain your current lifestyle?
- Do you expect your investments to go up in value with no setbacks?
- Would you be comfortable with some ups and downs in your investment's value?

Your finances

Consider all your benefits when evaluating your overall financial picture. For example:

- Do you have other sources of retirement income besides Social Security, your pension, and your Deferred Compensation Plan account?
- Do you have any big expenses that could reduce your retirement income?

Remember to consider your comfort level

When you're selecting which mix of investment options is right for you, factor in your age, your expectations, and your finances. Just as important is how much risk you are comfortable taking. While you now know that to achieve higher potential returns, you need to invest in higher-risk funds, you may not be comfortable with them. To give you a general idea of what kind of investor you are, take the quiz on the next page.

How to reduce risk

Some investments are by nature more stable than others. Spreading your money across several different kinds of investments (called diversifying) can help reduce your exposure to risk. That's because the returns of one investment may balance the volatile performance of another type of investment. In this way, diversification helps you balance risk and return potential.

Spreading your assets among a variety of investments can help you reduce risk over the long term.

How much risk are you comfortable with?

Spend a few moments taking the following quiz. It will help you see what kind of investor you are. Check your answers and total your score. Then look at the next page to see your results.

1. Which one of the following most closely describes your personal situation?

A. age 20 to 35, just beginning your career, starting a family soon, saving for major purchases (home, car, etc.) ○ 5 pts

B. age 30 to 50, saving for children's college education, paying for home ○ 3 pts

C. age 40 and up, saving seriously for retirement (which may be as near as five years), children are on their own ○ 1 pt

2. You win a sweepstakes that, after taxes, pays you $100,000. Of the following, which would you be most likely to do with the money?

A. invest in a home you can comfortably afford and plan to live in the rest of your life ○ 1 pt

B. pay off your current mortgage and "move up" to a more expensive home ○ 3 pts

C. invest in a resort property the developer promises will one day be a great success ○ 5 pts

3. Which one of the following scenarios would make you feel best about your investments?

A. you double your money in a stock fund in the first year, although it had a greater chance of loss than other investments ○ 5 pts

B. over the long term, your overall mix of investments protects you from loss and outpaces the rate of inflation ○ 3 pts

C. your stable value fund saves you from losing money in a market downturn ○ 1 pt

4. Of the following investment strategies, which do you consider the most important?

A. avoid any loss of money, even if that means you won't earn the highest possible return ○ 1 pt

B. take a moderate risk for the chance to earn higher returns ○ 3 pts

C. tolerate the possibility of losses for superior long-term growth potential ○ 5 pts

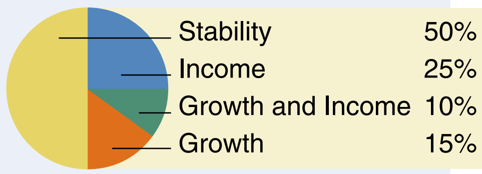
YOUR TOTAL SCORE ☐

Select investments that suit you

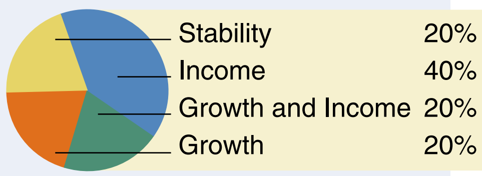
Find your risk score below and the appropriate pie chart. These charts represent model portfolios and will give you an idea of how you might consider dividing your contributions among different types of investments. Your retirement plan is only part of your investments — don't forget to include any other assets, income, and investments (e.g., home equity and other retirement plans or IRA accounts) when using these charts. These charts are for illustrative purposes only and should not be construed as investment advice. You may want to consult with a financial adviser regarding your specific situation.

Use the key that groups your funds on page 32. You'll notice each group has more than one fund. Select your fund choices based on the descriptions in this guide and on each fund's prospectus, which provides more detailed information about the fund.

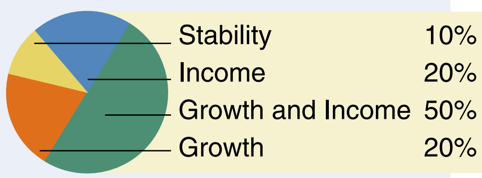
Score: 0-5
Low risk
You are already retired or need your Plan savings in less than five years. You seek maximum safety for your money and are satisfied with a lower but more stable rate of return on your investment.



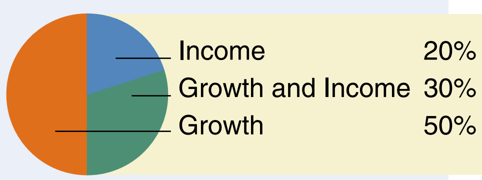
Score: 6-10
Low to moderate risk
You are willing to accept some risk in return for potentially higher returns. If you need your money in five years or longer, you may want to consider a moderate approach.



Score: 11-15
Moderate to high risk
Your need for your Plan savings is probably about 10 years away, or perhaps you are more comfortable with a more moderate approach than you have taken in the past. You are willing to accept greater risk in exchange for potentially higher returns than possible from a more conservative strategy.



Score: 16-20
High risk
Your need for your Plan savings is probably 10 or more years away. You are willing to accept substantially higher risk in exchange for potentially higher returns over the long term.



Four Investment Groups

The investment options in the Plan are grouped in four categories, depending on the kind and amount of risk they carry and their potential return.

Stability:

Investment options in the stability group seek to maintain a stable $1.00 share price, although the investment options cannot guarantee it. The value of the investment options' shares is neither insured nor guaranteed by the U.S. government. Such investment options are generally stable, but may offer lower returns than investment options in other groups. Money market and stable return investment options are in this category.

Income:

Investment options in this group seek current income. This involves slightly more risk-taking than stability investment options since the share price of these investment options will go up and down in value. These investment options have greater potential return than those in the stability group. Bond investment options are in this category.

Growth and Income:

Growth and income investment options seek long-term capital appreciation and current income. The investment options' balanced style of investing will tend to make these investment options less volatile than investment options in the growth category. Investment options in this group typically invest in high-yielding common stocks, preferred stocks, and bonds.

Growth:

Investment options in the growth group seek long-term capital appreciation. This group of investments may have even greater ups and downs in share price than those in the growth and income category, but they have greater return potential as well. Investment options with this objective are generally best suited for investors with 10 or more years until retirement and for those who can accept principal risk due to the ups and downs of the stock market.

The pie chart allocations were determined by using standard indices that represent each category for the period 1/73 to 12/00 (except as noted): stability, 30-day Treasury bills; income, Lehman Brothers Gov't. /Corp. Index (through 12/75) and Lehman Brothers U.S. Aggregate Index (1/76 to 12/00); growth, 15% MSCI EAFE Index and 85% Wilshire 5000 Total Market Index. The combinations of the categories were designed to correspond to various risk levels centered around a "balanced" portfolio (60% growth, 30% income, 10% stability). T. Rowe Price defined the "risk level" as the degree to which the monthly rates of return of a portfolio can differ from the average rate of return of the portfolio over a specific time period. T. Rowe Price also assumed that individuals would retire at age 65 and live for an additional 25 years, with the objective of earning a rate of return higher than the assumed rate of inflation of 4.5%.

The charts are for educational purposes and are not intended to be used as investment advice. You may want to consult with a financial planner regarding your specific situation.

Data Source: Ibbotson Associates, Chicago

The Plan's investment options on a risk and return potential scale

Stability
Low risk/low potential return

- Stable Return Fund
- Vanguard Prime Money Market Fund–Institutional Shares

Income
Lower to moderate risk/lower to moderate potential return

- T. Rowe Price New Income Fund
- Vanguard Total Bond Market Index Fund–Institutional Shares

Growth and Income
Moderate risk/moderate potential return

- Fidelity Fund
- Fidelity Puritan Fund
- Vanguard Institutional Index Fund

Growth
Higher risk/higher potential return

- Ariel Fund
- Liberty Acorn Fund
- PIC Small Cap Growth Fund–Institutional Shares
- T. Rowe Price International Stock Fund
- Wells Fargo Large Company Growth Fund–Institutional Shares

Build your investment mix

While you may wish to use the portfolios given on the "Answers" page (page 30) as a guideline, you'll want to build your own investment mix based on your individual needs.

For example, if your retirement is years away and you need the high potential reward that growth options carry, you may want to consider anchoring your investment mix with these investment options. However, if retirement is a couple of years away or you are not comfortable with the level of risk growth investments carry, it may be prudent for you to look to funds that generally have more stable prices.

Note: Investment options are placed in general risk/return categories based on past performance or, for newer investment options, the types of securities in which they invest. There is no assurance that past trends will continue.

Just ahead in Building Block #4...

What investments does the Plan offer? What does each invest in? How do I get more information about each? Read Building Block #4 to learn more about the options.